FINANCIALLY SUSTAINABLE COMMUNITIES!

PLANNING, MAINTENANCE & REPLACEMENT RESERVES

SWVA Chapter CAI

Roanoke, VA

MARCH 18, 2016

millerdodson ASSOCIATES | Capital Reserve Consultants

Housekeeping Note …

www.mdaReserves.com

TOPICS

- **Financially Sustainable Communities**
- **Maintenance and Reserves**
- **Sample Report – Understanding the Numbers**
- **Cash Flow versus Component Method**

Meet Mrs. Jones…

- Retired school teacher,
- Lives on a fixed income,
- Has lived in her HOA for 20 years,
- She is the ideal neighbor!
- As a member of the Board of Directors,

you are foreclosing on her home!

How Could This Happen?

Lack of Planning!

- Resulted in a Special Assessment, or
- Resulted in precipitous increases in Normal Assessments!

Lack of Planning?

- **Inadequate Operations budget** did not plan or allow for use of professional consultants!
- **Inadequate Maintenance budget** resulted in premature deterioration!
- Inadequate planning by the Board resulted in **inadequate Reserves**!

Food for Thought:

Almost all community financial disasters result not from an event,…
but from lack of planning!

Reserve Funding Pitfall Cycle

- **Lack of Adequate Reserve Funding** will result in **higher future assessments**.
- **Higher Future Assessments** (or special assessments) will result in **financial hardship for some owners**.
- **Financial Hardship** result in **more delinquencies**.
- **More Delinquencies** mean **less annual revenue**!
- **Less Annual Revenue** means **higher future assessments** for others!

Reasons for a Reserve Study

- **Legal Aspects**
- **Financial Aspects**
- **Ethical Aspects**

Legal Aspects

- **State Law,** where applicable;
- **Fiduciary Duty of Board**;
- **IRS Guidelines for Reserve Funds;**
- **FHA Compliance Guidelines** (Condo Mortgages)

Financial Aspects

- **Vital data for budgeting process;**
- **Independent professional opinion**
- **Institutionalizes decisions**

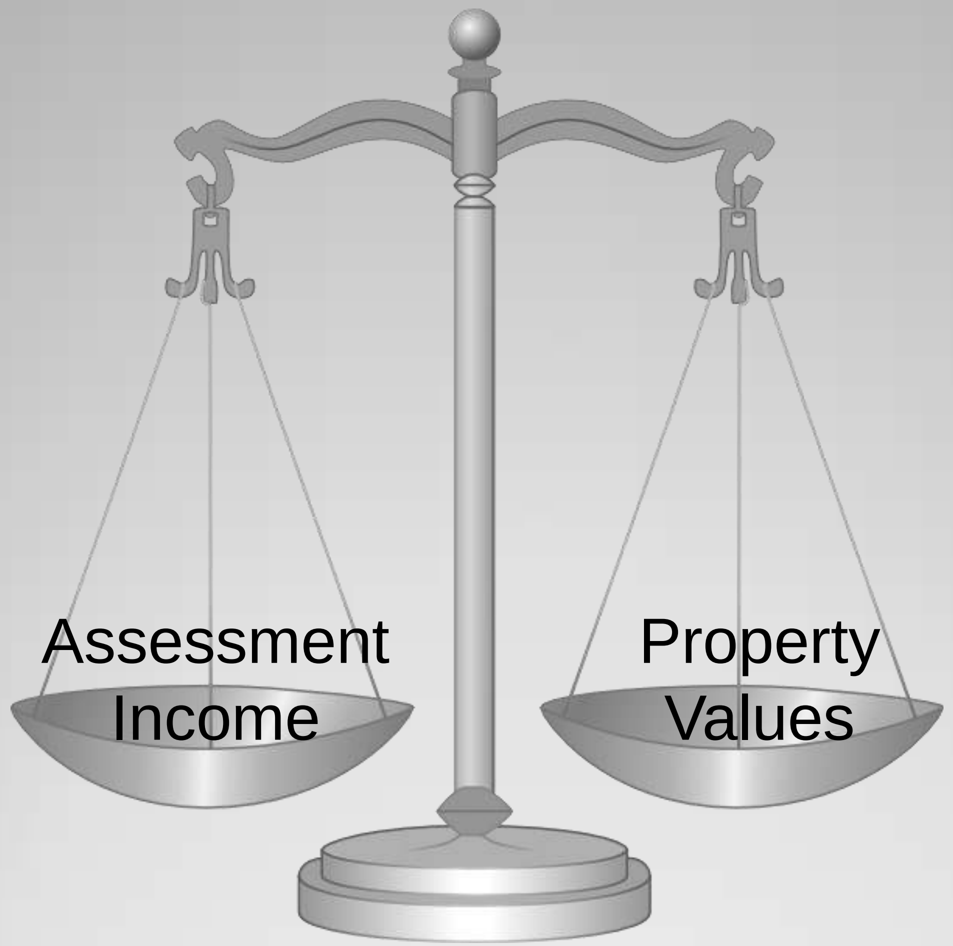
Ethical Aspects

- **Protect, Preserve and Enhance**
  - Property values in the community;
  - Investment of Owners;
- Ensure that everyone pays their fair share for the period of time that they live there!
- Protect Owners from unduly high assessments or Special Assessments!

Financially Sustainable Community

- Acknowledging and functioning within the exigencies of the present economy without limiting the financial abilities of the future.

- Balancing the need for adequate budget (assessments) against the realities of today's housing market.


Assessment
Income
Property
Values

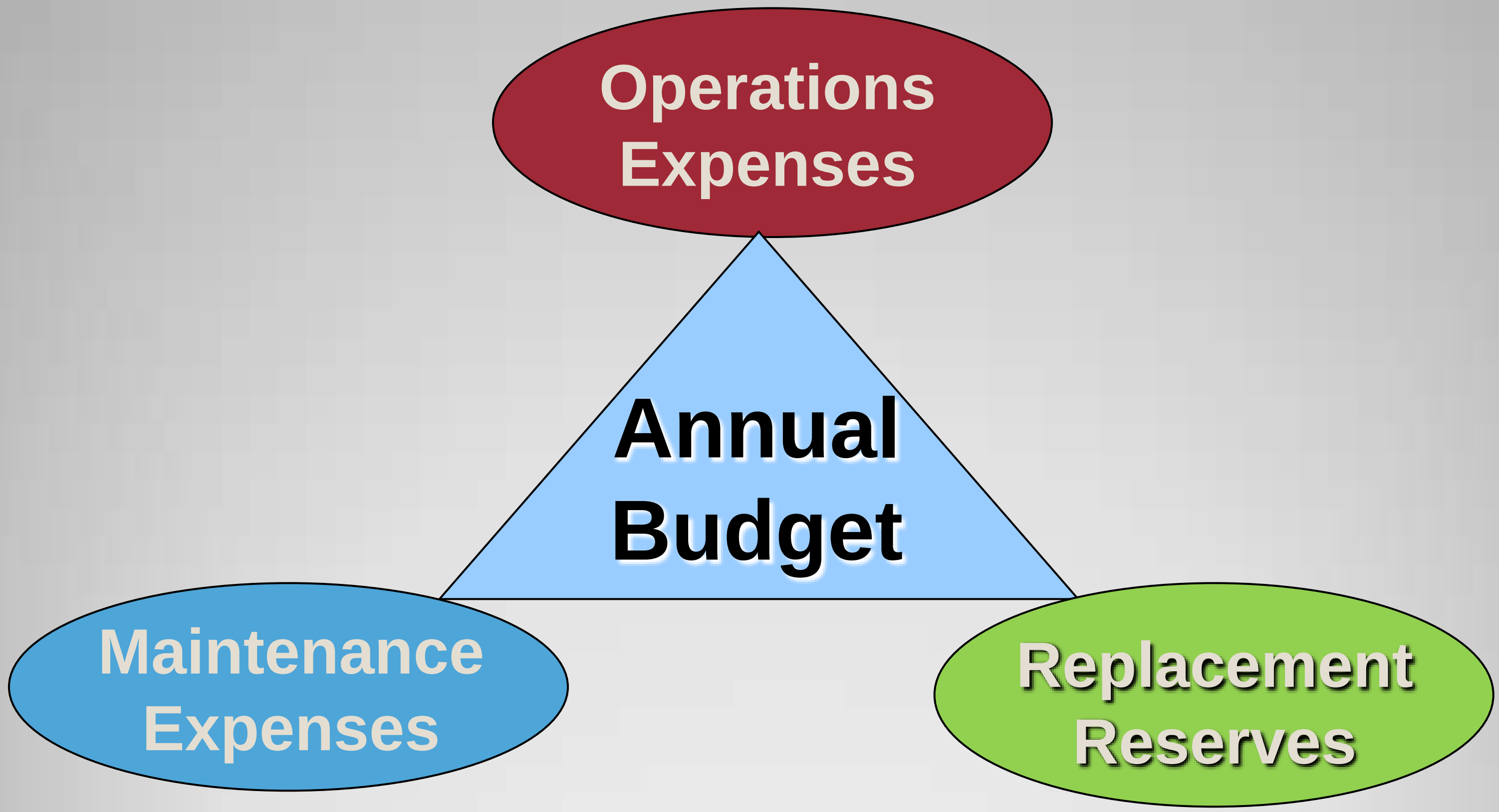
Financially Sustainable Community

- **Annual Budget is balanced and adequate…**
- **Normal Assessments are adjusted appropriately each year for inflation (as gauged by the PPI).**
- **Property Values are Protected, Preserved & Enhanced!**

Congratulations! Your community is

Financially Sustainable!

Financially Sustainable Community



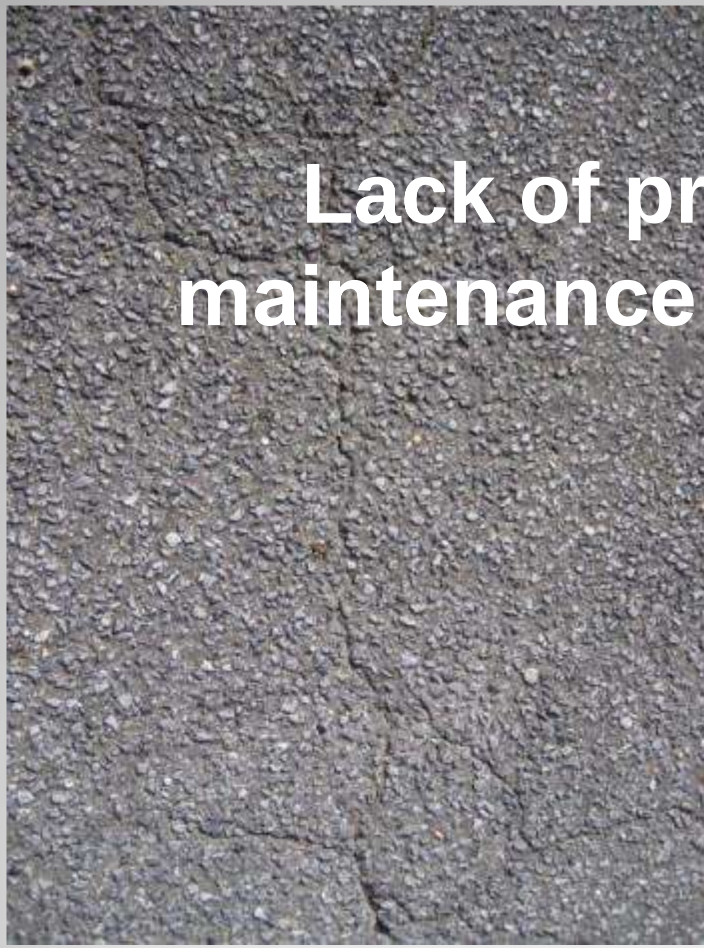
Four Truths!

1. All commonly-owned components will eventually have to be replaced!
2. Money spent on sound maintenance is money soundly spent!
3. All materials deteriorate over time!
4. All material costs increase over time!

Understand Inflation - CPI versus PPI

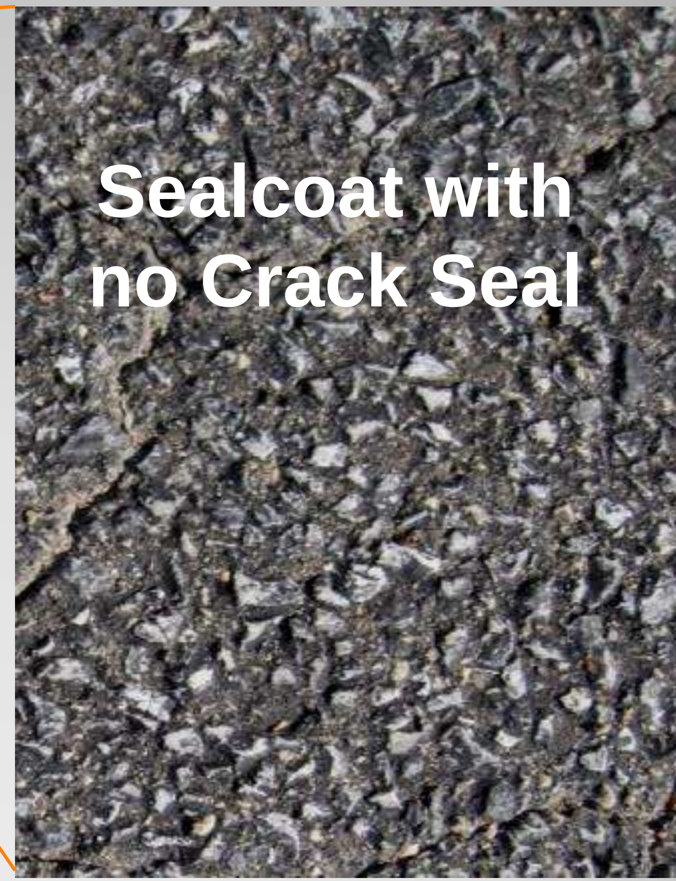
- **Consumer Price Index (CPI)**
  - Food Costs
  - Fuel Costs
  - Electricity Costs
  - Housing Costs (rent)
- **Producer Price Index (PPI)** gauges
  - Manufacturing costs
  - Construction costs

Example #1



Lack of proper asphalt maintenance in parking lot…

Example #1

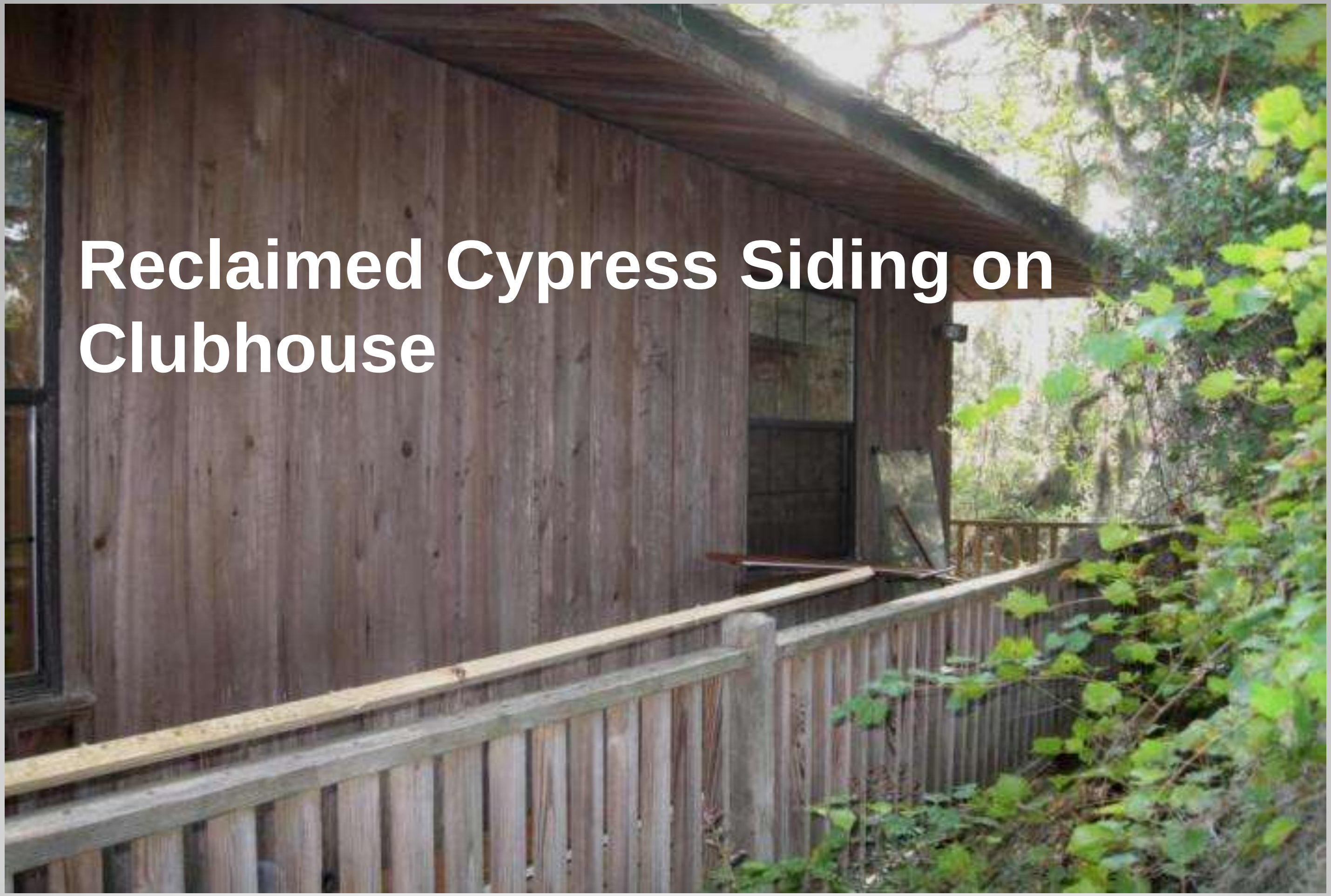


Example #1

Example #1

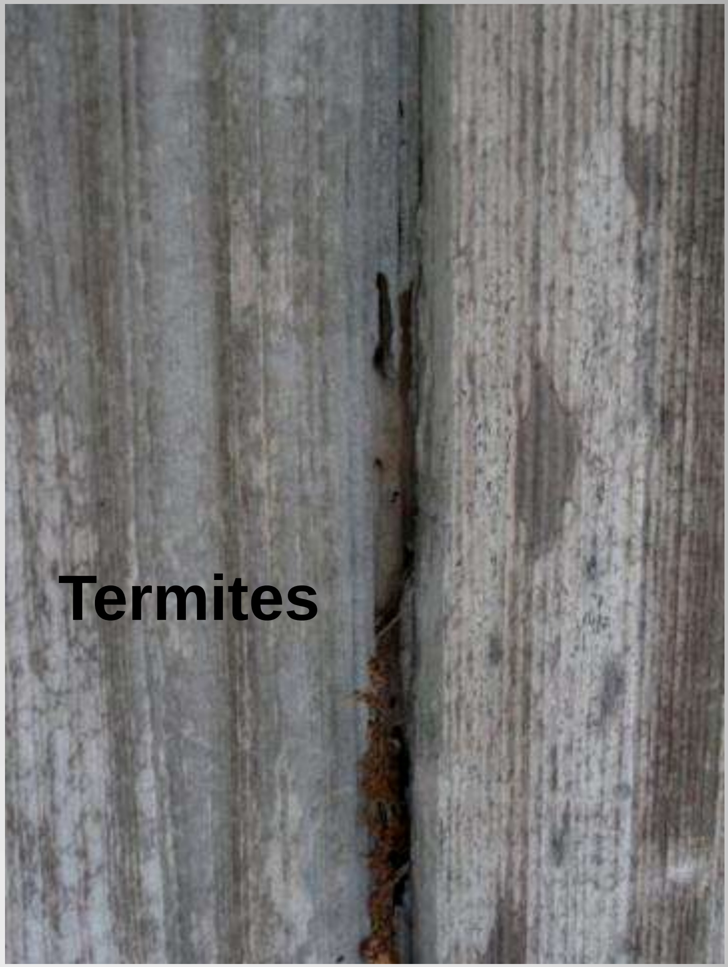
Example #2

Example #2



Reclaimed Cypress Siding on Clubhouse

Example #2



Example #2

Example #3

Example #3

Example #3

Strategy for Financial Sustainability

- Involve Your Experts early and often!
- Optimize “Economic Life” of Facilities, systems and components with proper maintenance.
- **Reserve** For Timely Replacement.
- Use Best Practices For Replacements.

Involve You Experts Early and Often!

- You aren't expected to know everything!
- Call on the appropriate experts!
- Investigate before acting (or not acting)!
- Use experts to assist the Board!
  - Investigations, Scope of Work, Contracts, Etc.
  - Presentations to the Owners

Optimize Economic Life - Maintenance

- Sound preventative maintenance makes sound economic sense!
- The longer an asset (reasonably) stays in service, the lower the life-cycle cost, and thus, the less the Replacement Reserve need.
- Saving money on maintenance just to save money is wasting money long-term!

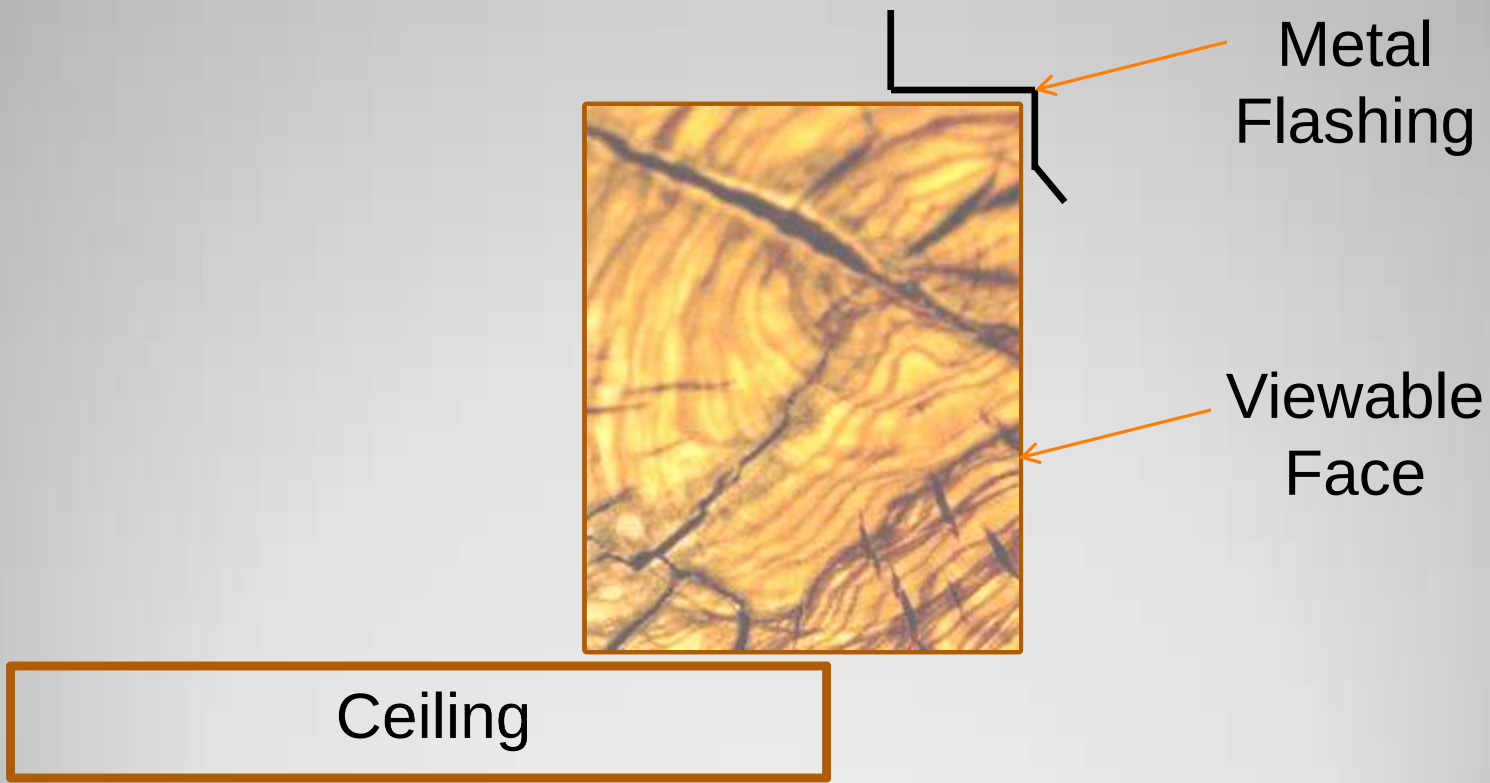
Use Best Practices for Replacement

- Hire the <u>Best</u> Contractor that you can find!
- Use the <u>Best</u> <u>Appropriate</u> Materials for the job.
  - Upgrade to a better quality, or
  - Consider alternative materials if applicable.
  - Do the necessary prep work before installation.

Involve your experts to investigate

Side View (Face) of Wood Beam Section

Involve your experts early & often



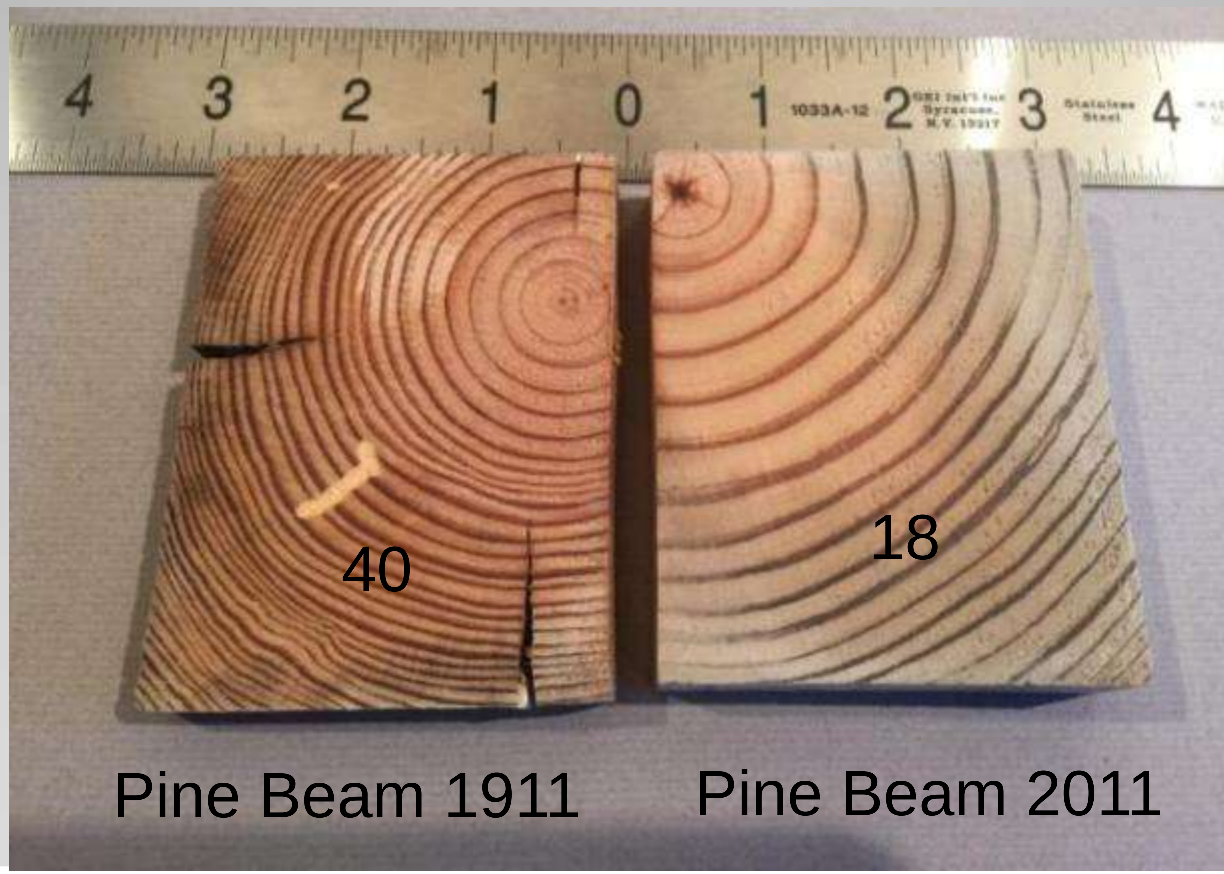
Call on your experts to investigate

Cross Section of Pine Beam

Face

Use the Best Materials for the Job

Upgrade or consider alternative material …



Food for Thought:

Almost all CA financial disasters result not from an event,...

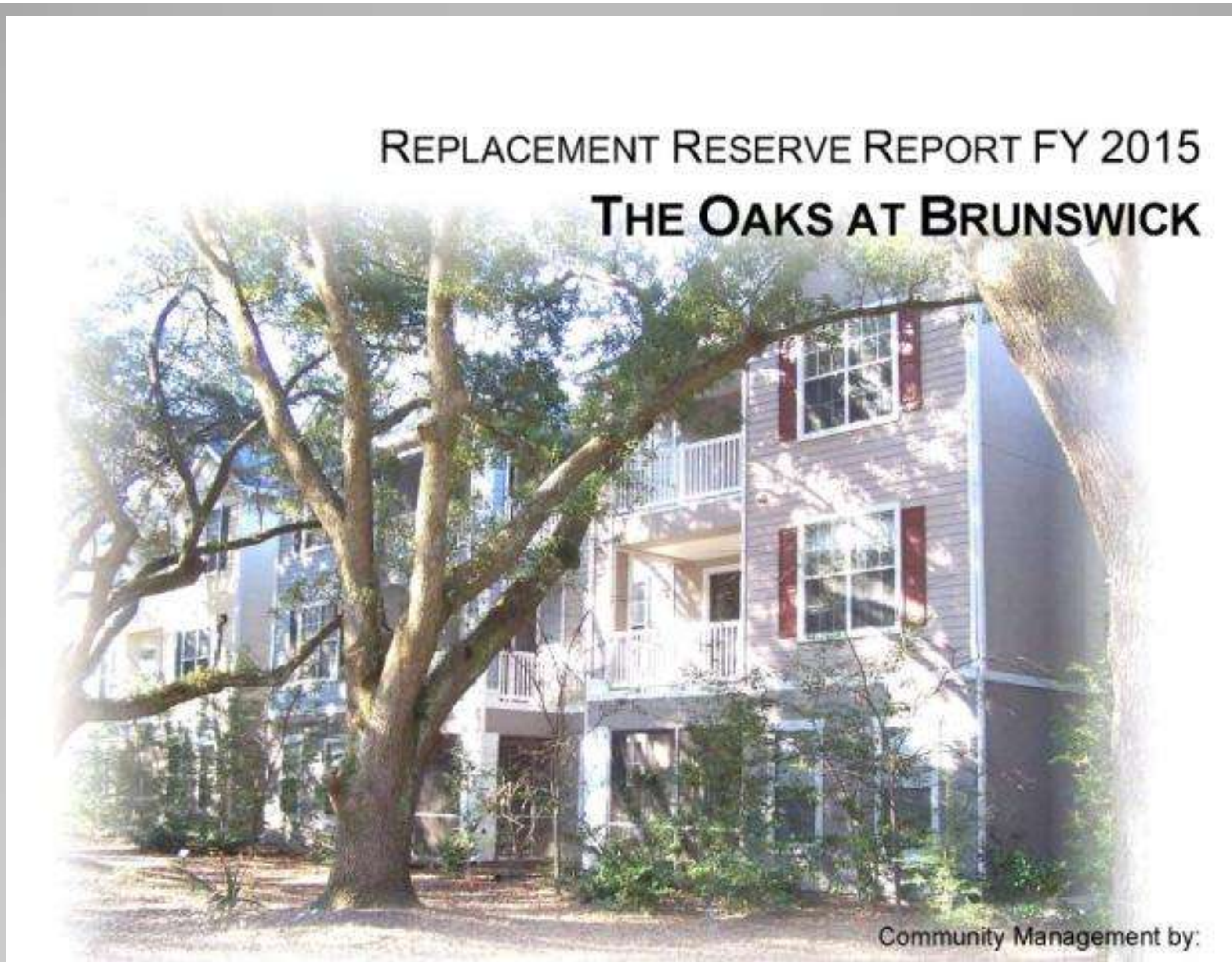
but from lack of planning!

She has spent $9,000 on condo association fees over five years.

She had to come up with $12,000 more in three months. She couldn't.

Questions

Understanding the Numbers – Sample Reserve Study


REPLACEMENT RESERVE REPORT FY 2015
THE OAKS AT BRUNSWICK
Community Management by:

Current Reserve Funding: $90,000

GENERAL SITE IMPROVEMENTS
PROJECTED REPLACEMENTS

ITEM #	ITEM DESCRIPTION	UNIT	NUMBER OF UNITS	UNIT REPLACEMENT COST ($)	NORMAL ECONOMIC LIFE (YRS)	REMAINING ECONOMIC LIFE (YRS)	REPLACEMENT COST ($)
1	Asphalt road and parking area	sf	157,053	$1.30	20	15	$204,169
2	Seal coat asphalt	sf	157,053	$0.16	5	none	$25,128
3	Concrete curb & gutter (20%)	lf	1,072	$34.00	54	6	$36,448
4	Concrete flatwork (6%)	sf	817	$8.50	60	6	$6,945
	Repoint masonry entrance feature	sf	20				
5	Sandblasted wood signage	ls	1	$1,200.00	15	10	$1,200
6	Segmental retaining wall, 30%	sf	697	$45.00	40	35	$31,361
7	Mailboxes	ls	1	$18,000.00	25	15	$18,000
8	Dumpster pad	sf	816	$10.00	25	20	$8,160
9	Dumpster enclosure stucco repair	sf	805	$12.75	50	45	$10,264
10	Dumpster trellace	ls	1	$1,500.00	20	15	$1,500
11	Dumpster gates	pr	1	$1,000.00	10	5	$1,000
12	Site lighting	ea	26	$2,100.00	30	25	$54,600
13	Sanitary sewer - mains (10%)	unit	216	$155.00	20	15	$33,480
14	Domestic water - mains (10%)	unit	216	$95.00	20	15	$20,520
15	Storm water - structure & pipe (10%)	unit	216	$185.00	20	15	$39,960
16	Storm water pond dredging	ls	1	$50,000.00	20	15	$50,000
	GENERAL SITE IMPROVEMENTS - Replacement Costs - Subtotal						$542,734

CONDOMINIUM BUILDING EXTERIORS, Con't (CB)

PROJECTED REPLACEMENTS

ITEM #	ITEM DESCRIPTION	UNIT	NUMBER OF UNITS	UNIT REPLACEMENT COST ($)	NORMAL ECONOMIC LIFE (YRS)	REMAINING ECONOMIC LIFE (YRS)	REPLACEMENT COST ($)
34	CB Windows, 20%	sf	2,232	$35.00	30	21	$78,120
35	CB Windows, 20%	sf	2,232	$35.00	30	23	$78,120
36	CB Windows, 20%	sf	2,232	$35.00	30	25	$78,120
37	CB Windows, 20%	sf	2,232	$35.00	30	27	$78,120
38	CB Windows, 20%	sf	2,232	$35.00	30	29	$78,120
39	CB Window shutters	pr	160	$100.00	15	10	$16,000
40	CB Doors, 20%	ea	43	$950.00	25	18	$41,040
41	CB Doors, 20%	ea	43	$950.00	25	19	$41,040
42	CB Doors, 20%	ea	43	$950.00	25	20	$41,040
43	CB Doors, 20%	ea	43	$950.00	25	21	$41,040
44	CB Doors, 20%	ea	43	$950.00	25	22	$41,040
45	CB Patio doors, 20%	ea	12	$1,470.00	25	18	$17,640
46	CB Patio doors, 20%	ea	12	$1,470.00	25	19	$17,640
47	CB Patio doors, 20%	ea	12	$1,470.00	25	20	$17,640
48	CB Patio doors, 20%	ea	12	$1,470.00	25	21	$17,640
49	CB Patio doors, 20%	ea	12	$1,470.00	25	22	$17,640
	CONDOMINIUM BUILDING EXTERIORS, Con't (CB) - Replacement Costs - Subtotal						$700,000

SWIMMING POOL
PROJECTED REPLACEMENTS

ITEM #	ITEM DESCRIPTION	UNIT	NUMBER OF UNITS	UNIT REPLACEMENT COST ($)	NORMAL ECONOMIC LIFE (YRS)	REMAINING ECONOMIC LIFE (YRS)	REPLACEMENT COST ($)
66	Swimming pool - structure	sf	990	$70.00	45	40	$69,300
67	Swimming pool - finish	sf	990	$3.50	10	4	$3,465
68	Swimming pool - waterline tile	ft	135	$40.00	15	10	$5,400
69	Swimming pool pump (2 - 5 hp)	ea	1	$3,200.00	10	5	$3,200
70	Swimming pool filter/chlorinator	sf	990	$4.00	20	15	$3,960
71	Swimming pool valves & plumbing	sf	990	$2.00	20	15	$1,980
72	Swimming pool - concrete deck, 25%	sf	480	$10.25	30	5	$4,920
73	Swimming pool - concrete deck, 25%	sf	480	$10.25	30	10	$4,920
74	Swimming pool - concrete deck, 25%	sf	480	$10.25	30	15	$4,920
75	Swimming pool - concrete deck, 25%	sf	480	$10.25	30	20	$4,920
76	Swimming pool deck coating	sf	1,920	$10.00	10	6	$19,200
77	Swimming pool furniture (50%)	ls	1	$1,950.00	8	1	$1,950
78	Swimming pool furniture (50%)	ls	1	$1,950.00	8	3	$1,950
79	Spa structure	sf	50	$100.00	45	40	$5,024
80	Spa finish	sf	50	$10.00	10	4	$500
81	Spa waterline tile	lf	25	$40.00	15	10	$1,005
82	Spa filter/chlorinator	ls	1	$2,500.00	20	15	$2,500
83	Swimming pool lighting	ea	7	$900.00	30	25	$6,300
84	Pool perimeter fence - 6' (metal)	ft	186	$55.00	30	25	$10,230
85	Swimming pool retaining wall	sf	165	$40.00	35	30	$6,600
			SWIMMING POOL - Replacement Costs - Subtotal				$162,244

PROJECTED REPLACEMENTS - YEARS 4 TO 6

Item	2018 - YEAR 4	$
78	Swimming pool furniture (50	$1,950
	Total Scheduled Replacements	$1,950

Item	2019 - YEAR 5	$
67	Swimming pool - finish	$3,465
80	Spa finish	$500
	Total Scheduled Replacements	$3,965

Item	2020 - YEAR 6	$
2	Seal coat asphalt	$25,128
11	Dumpster gates	$1,000
27	CB EIFS coating	$344,960
69	Swimming pool pump (2 - 5	$3,200
72	Swimming pool - concrete d	$4,920
88	CO EIFS coating	$10,836
95	FC EIFS coating	$3,864
99	FC HVAC system	$2,500
	Total Scheduled Replacements	$396,408

Miller + Dodson Associates, Inc. — Projected Annual Replacements - Page C10

Oaks at Brunswick — June 14, 2014

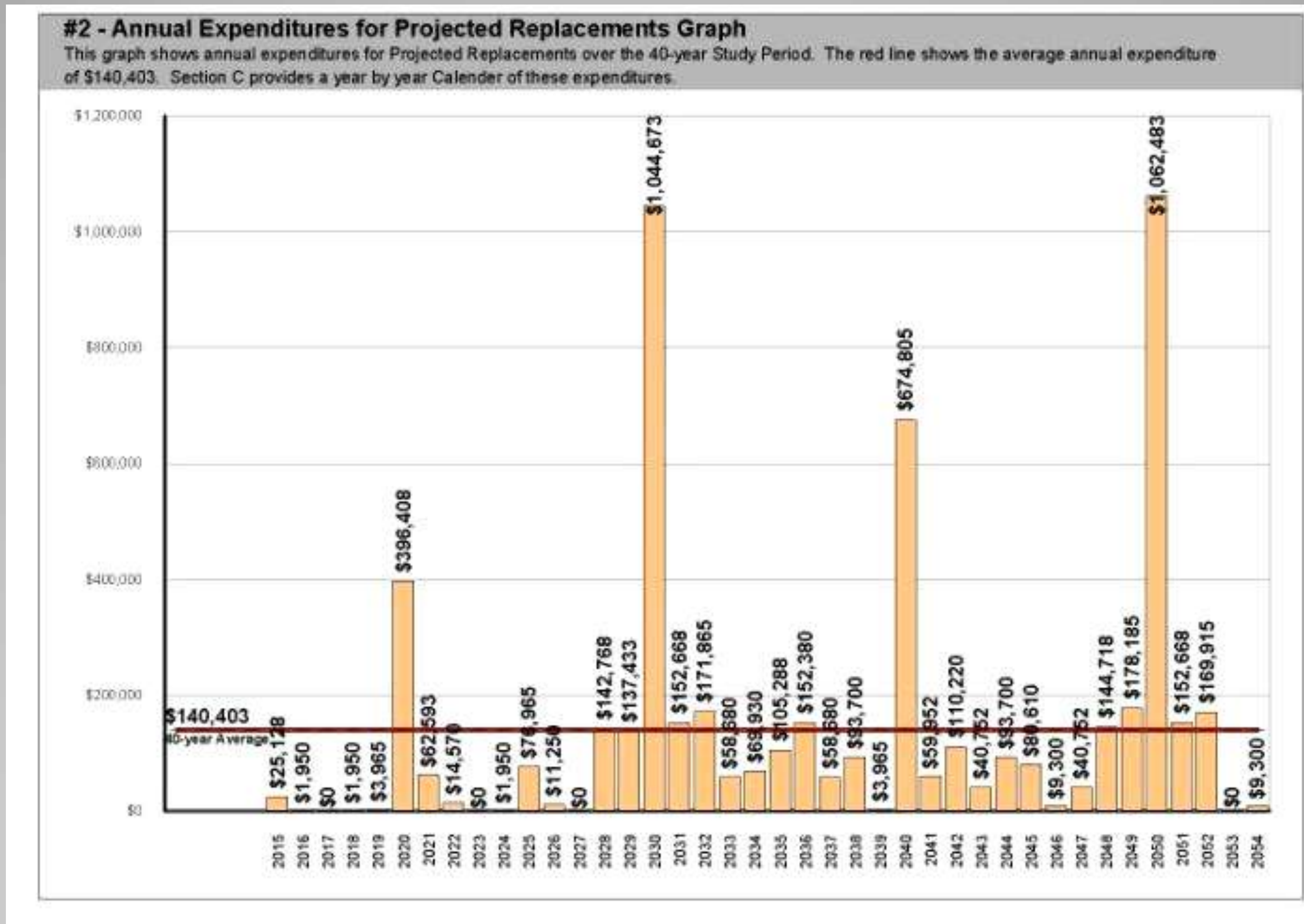
10624102OAKS AT15

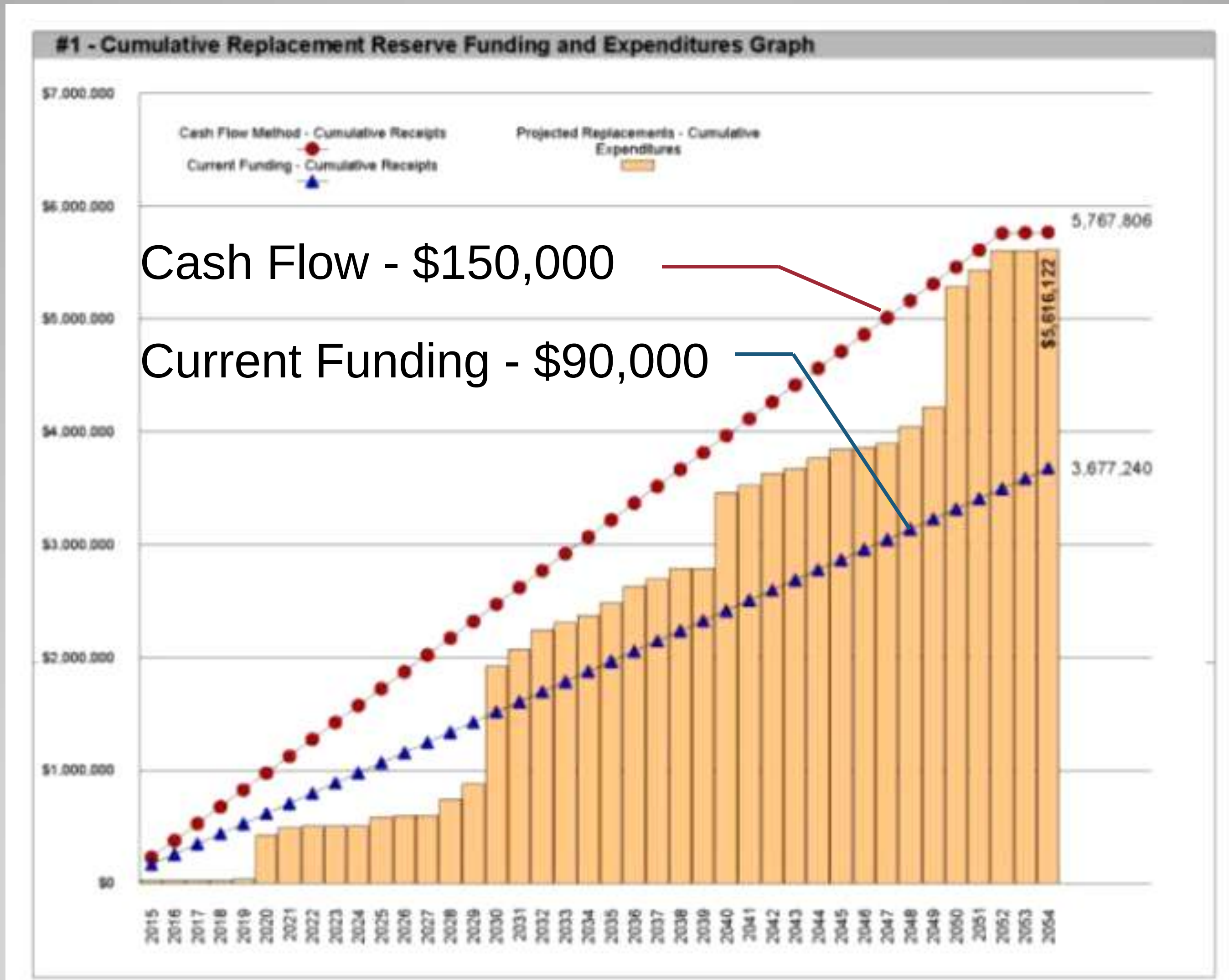
PROJECTED REPLACEMENTS - YEARS 25 TO 27

Item	2039 - YEAR 25	$
67	Swimming pool - finish	$3,465
80	Spa finish	$500
	Total Scheduled Replacements	$3,965

Item	2040 - YEAR 26	$
2	Seal coat asphalt	$25,128
5	Sandblasted wood signage	$1,200
11	Dumpster gates	$1,000
12	Site lighting	$54,600
27	CB EIFS coating	$344,960
36	CB Windows, 20%	$78,120
39	CB Window shutters	$16,000
55	CB Balcony structure	$58,800
56	CB Balcony surface	$21,112
60	CB Stairs, 20%	$15,580
65	CB Exit lights	$4,500
68	Swimming pool - waterline ti	$5,400
69	Swimming pool pump (2 - 5	$3,200
77	Swimming pool furniture (50	$1,950
81	Spa waterline tile	$1,005
83	Swimming pool lighting	$6,300
84	Pool perimeter fence - 6' (m	$10,230
88	CO EIFS coating	$10,836
90	CO Windows	$8,820
91	CO Window shutters	$1,000
95	FC EIFS coating	$3,864
100	FC HVAC condensing unit	$1,200
	Total Scheduled Replacements	$674,805

Item	2041 - YEAR 27	$
29	CB Vinyl siding, 20%	$40,752
76	Swimming pool deck coatin	$19,200
	Total Scheduled Replacements	$59,952


#2 - Annual Expenditures for Projected Replacements Graph
This graph shows annual expenditures for Projected Replacements over the 40-year Study Period. The red line shows the average annual expenditure of $140,403. Section C provides a year by year Calender of these expenditures.
$1,200,000
$1,000,000
$800,000
$600,000
$400,000
$200,000
$0
$140,403
40-year Average
$25,128
$1,950
$0
$1,950
$3,965
$396,408
$62,593
$14,570
$0
$1,950
$76,965
$11,250
$0
$142,768
$137,433
$1,044,673
$152,668
$171,865
$58,680
$69,930
$105,288
$152,380
$58,680
$93,700
$3,965
$674,805
$59,952
$110,220
$40,752
$93,700
$80,610
$9,300
$40,752
$144,718
$178,185
$1,062,483
$152,668
$169,915
$0
$9,300
2015
2016
2017
2018
2019
2020
2021
2022
2023
2024
2025
2026
2027
2028
2029
2030
2031
2032
2033
2034
2035
2036
2037
2038
2039
2040
2041
2042
2043
2044
2045
2046
2047
2048
2049
2050
2051
2052
2053
2054


#1 - Cumulative Replacement Reserve Funding and Expenditures Graph
Cash Flow Method - Cumulative Receipts
Current Funding - Cumulative Receipts
Projected Replacements - Cumulative Expenditures
5,767,806
3,677,240
$5,616,122
Cash Flow - $150,000
Current Funding - $90,000

OK! Now What?

- You as the Manager…
- You as a Board Member…
- You as a Finance Committee Member…

What's the Next Step?

You were just handed this report!

It says to increase the Reserve Funding from $90K to $150K!

Holy Cr@p!

That's a $60K annual increase!

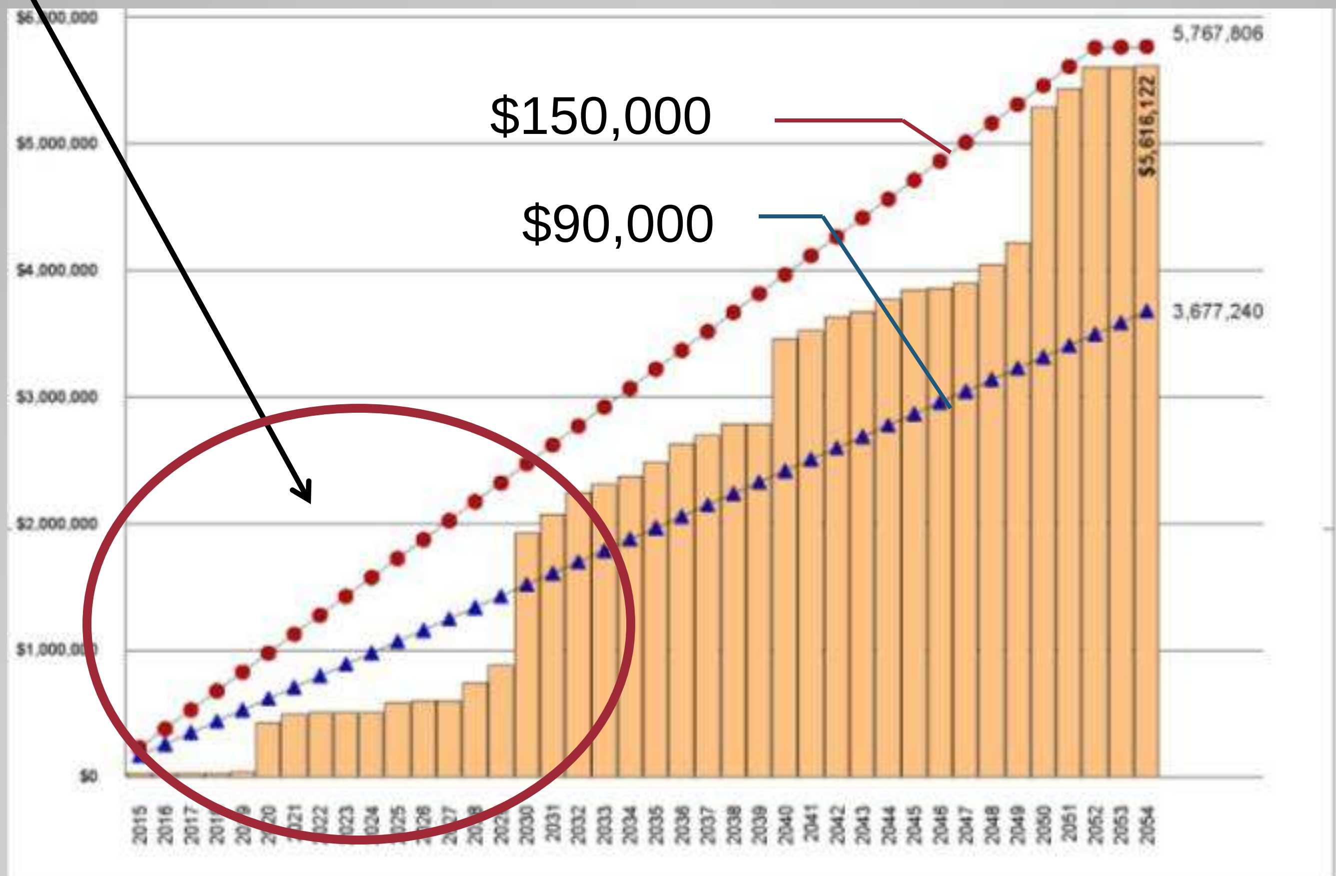
What Are Your Alternatives?

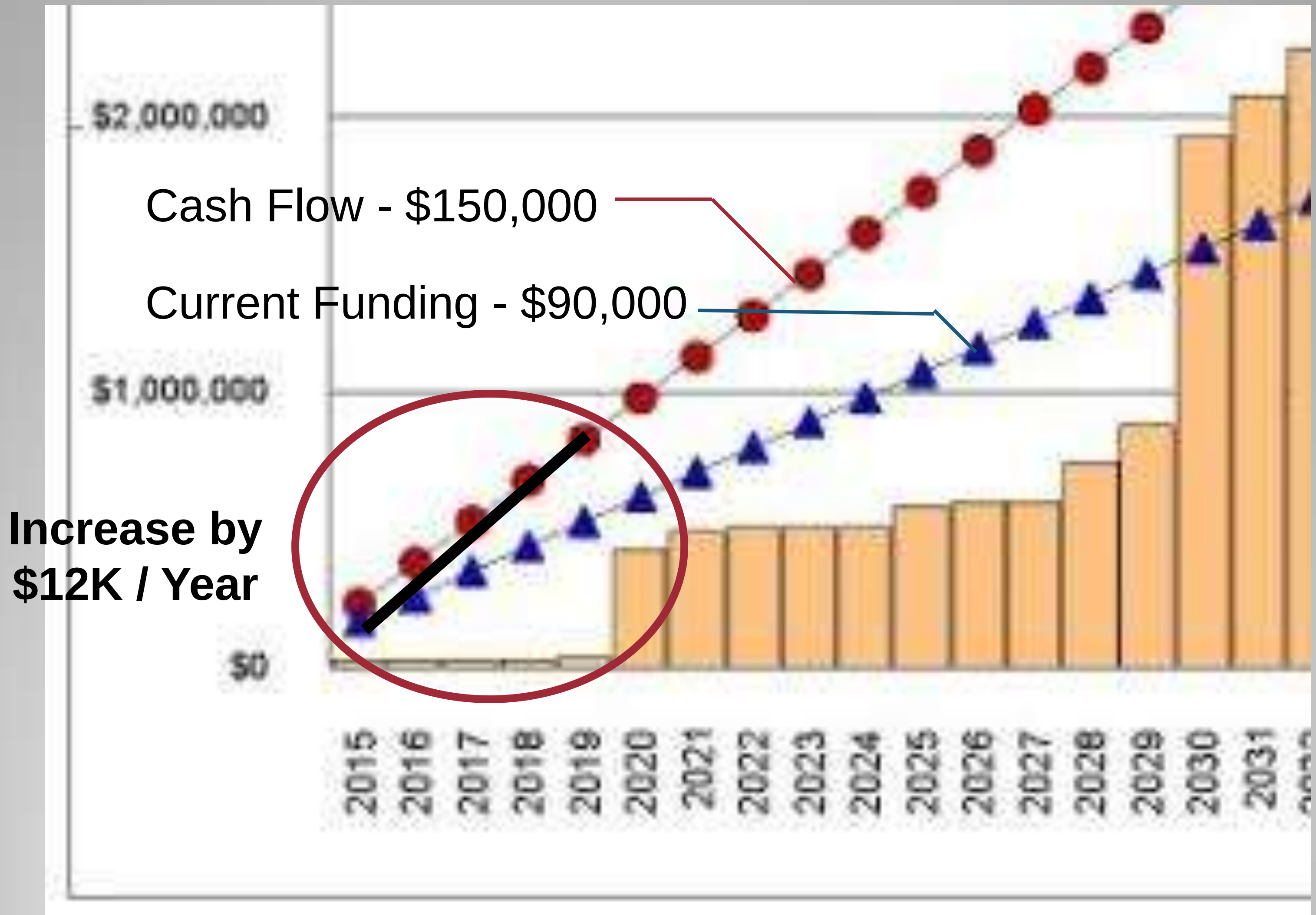
- Increase Normal Assessments
- Special Assessment
- Commercial Bank Loan

Next Steps in this process:

1. Review inventory data.
2. Re-think replacement priorities.
3. Check Cash Flow margins.
4. Develop **Strategic Funding Plan**.

This association has the leeway to “ramp up” rather than have one large increase




$2,000,000
$1,000,000
$0
Cash Flow - $150,000
Current Funding - $90,000
Increase by
$12K / Year
2015
2016
2017
2018
2019
2020
2021
2022
2023
2024
2025
2026
2027
2028
2029
2030
2031

Strategic Funding Plan #1

Ramp Up Annual Funding over five years:

Year 1: $90K to $102K

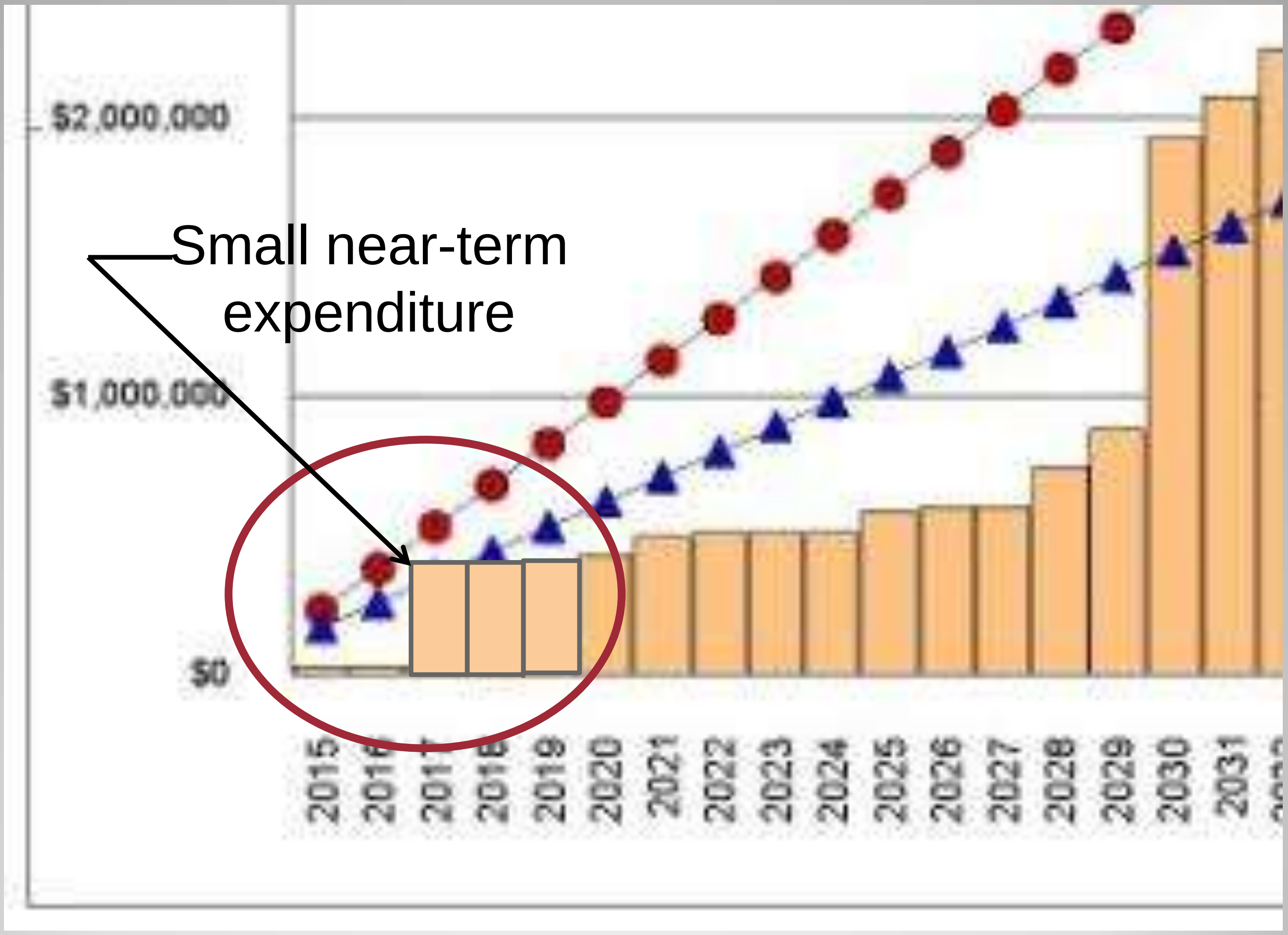
Year 2: $102K to $114K

Year 3: $114K to $126K

Year 4: $126K to $138K

Year 5: $138K to $150K *

*Year 5 would bring Reserve Study update and would adjust for inflation, underfunding, changed conditions.

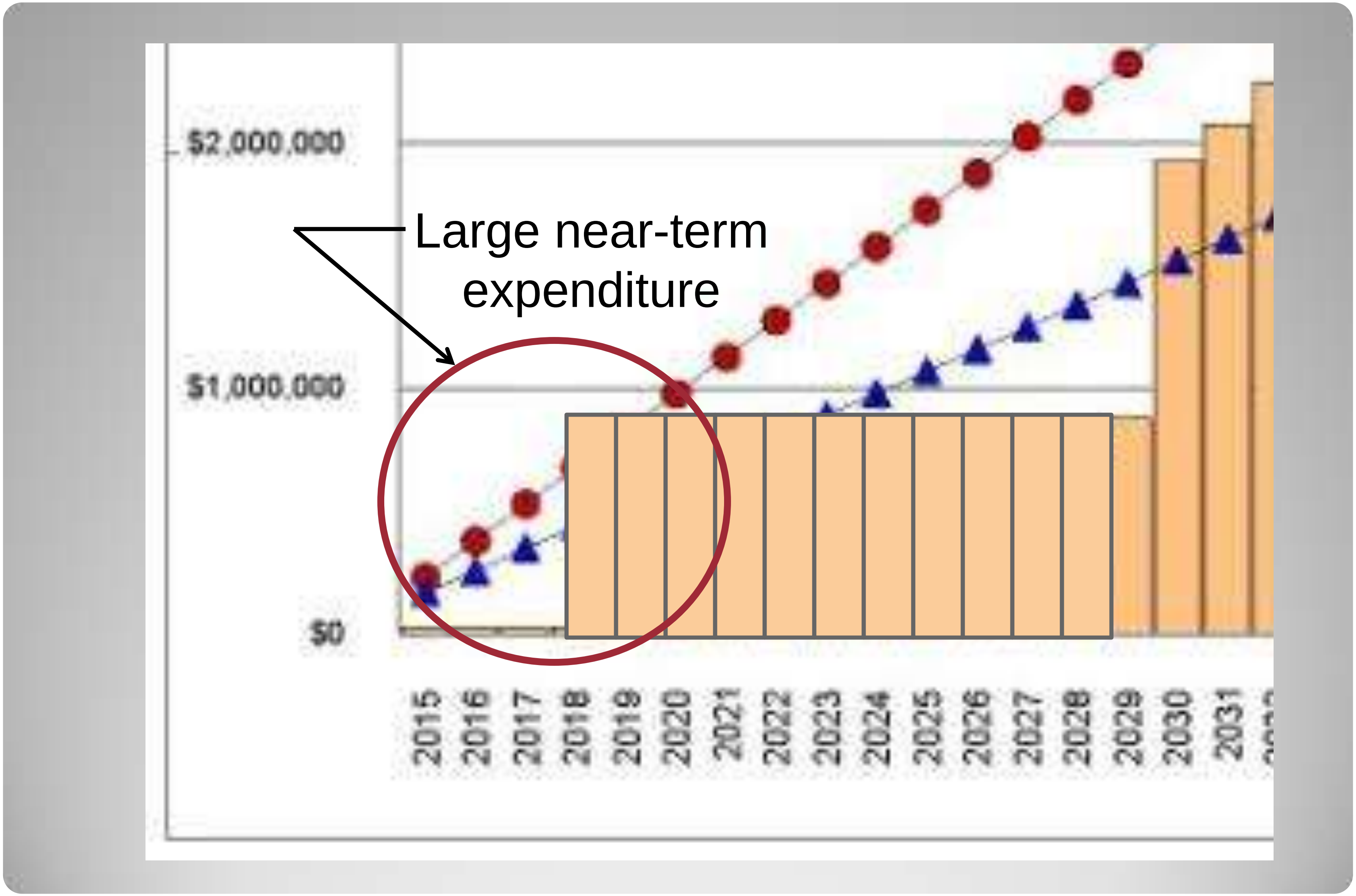


Small near-term expenditure
$2,000,000
$1,000,000
$0
2015
2016
2017
2018
2019
2020
2021
2022
2023
2024
2025
2026
2027
2028
2029
2030
2031

Strategic Funding Plan #2

Small Near-term Expenditure

- Increase Normal Assessments as planned,
- Plan Small Special Assessment,
- Combine Special Assessment with Bank Loan..
  - Pay up front, or
  - Pay <u>with interest </u>from bank loan


Large near-term expenditure
$2,000,000
$1,000,000
$0
2015
2016
2017
2018
2019
2020
2021
2022
2023
2024
2025
2026
2027
2028
2029
2030
2031

Strategic Funding Plan #3

Large Near-term Expenditures

- Increase Normal Assessments as planned,
- Fund large expenditure with Bank Loan.
  - Bank Loan term can be 3 to 10 years

Questions

CASH FLOW v COMPONENT (Pooling vs. Full Funding)

- **CASH FLOW** ("Pooling") METHOD
  - Treats Reserves as an aggregate "pool" of funds.
- **COMPONENT** ("Full Funding") METHOD
  - Treats each Reserve Item as a separate "line item" budget.

CASH FLOW vs. COMPONENT

Illustration of the Different Mathematical Models

- Four Buildings
- Painted 1 per year
- Cost of $12,000 per building
- (Assume $Zero Starting Balance)
- (Assume $Zero Threshold)

Funding Calculations

	YEAR	1st	2nd	3rd	4th	Total
COMPONENT	Cost X $1000	**Annual Contributions to Reserves**				
Painting Building One	$12	X				
Painting Building Two	$12		X			
Painting Building Three	$12			X		
Painting Building Four	$12				X	
Total Cost	$48					

Cash Flow Calculations

	YEAR	1st	2nd	3rd	4th	Total
COMPONENT	Cost X $1000	**Annual Contributions to Reserves**				
Painting Building One	$12	3				3
Painting Building Two	$12	3				3
Painting Building Three	$12	3				3
Painting Building Four	$12	3				3
Total Cost	$48	$12				$12

Cash Flow Calculations

	YEAR	1st	2nd	3rd	4th	Total
COMPONENT	Cost X $1000	**Annual Contributions to Reserves**				
Painting Building One	$12	3	3			6
Painting Building Two	$12	3	3			6
Painting Building Three	$12	3	3			6
Painting Building Four	$12	3	3			6
Total Cost	$48	12	$12			$24

Cash Flow Calculations

	YEAR	1st	2nd	3rd	4th	Total
COMPONENT	Cost X $1000	**Annual Contributions to Reserves**				
Painting Building One	$12	3	3	3		9
Painting Building Two	$12	3	3	3		9
Painting Building Three	$12	3	3	3		9
Painting Building Four	$12	3	3	3		9
Total Cost	$48	12	12	$12		$36

Cash Flow Calculations

	YEAR	1st	2nd	3rd	4th	Total
COMPONENT	Cost X $1000	**Annual Contributions to Reserves**				
Painting Building One	$12	3	3	3	3	12
Painting Building Two	$12	3	3	3	3	12
Painting Building Three	$12	3	3	3	3	12
Painting Building Four	$12	3	3	3	3	12
Total Cost	$48	12	12	12	$12	$48

Cash Flow Calculations

	YEAR	1st	2nd	3rd	4th	Total
COMPONENT	Cost X $1000	**Annual Contributions to Reserves**				
Painting Building One	$12	3	3	3	3	12
Painting Building Two	$12	3	3	3	3	12
Painting Building Three	$12	3	3	3	3	12
Painting Building Four	$12	3	3	3	3	12
Total Cost	$48	12	12	12	$12	**$48**

Component Method Calculations

	YEAR	1st	2nd	3rd	4th	Total
COMPONENT	Cost X $1000	**Annual Contributions to Reserves**				
Painting Building One	$12	X				
Painting Building Two	$12		X			
Painting Building Three	$12			X		
Painting Building Four	$12				X	
Total Cost	$48					

Component Method Calculations

	YEAR	1st	2nd	3rd	4th	Total
COMPONENT	Cost X $1000	**Annual Contributions to Reserves**				
Painting Building One	$12	12				$12
Painting Building Two	$12	6				$6
Painting Building Three	$12	4				$4
Painting Building Four	$12	3				$3
Total Cost	$48	$25				**$25**

Component Method Calculations

	YEAR	1st	2nd	3rd	4th	Total
COMPONENT	Cost X $1000	**Annual Contributions to Reserves**				
Painting Building One	$12	12	3			$15
Painting Building Two	$12	6	6			$12
Painting Building Three	$12	4	4			$8
Painting Building Four	$12	3	3			$3
Total Cost	$48	$25	$16			**$38**

Component Method Calculations

	YEAR	1st	2nd	3rd	4th	Total
COMPONENT	Cost X $1000	**Annual Contributions to Reserves**				
Painting Building One	$12	12	3	3		$18
Painting Building Two	$12	6	6	3		$15
Painting Building Three	$12	4	4	4		$12
Painting Building Four	$12	3	3	3		$9
Total Cost	$48	$25	$16	$13		**$54**

Component Method Calculations

	YEAR	1st	2nd	3rd	4th	Total
COMPONENT	Cost X $1000	**Annual Contributions to Reserves**				
Painting Building One	$12	12	3	3	3	21
Painting Building Two	$12	6	6	3	3	18
Painting Building Three	$12	4	4	4	3	15
Painting Building Four	$12	3	3	3	3	12
Total Cost	$48	$25	$16	$13	$12	$66

Component Method Calculations

	YEAR	1st	2nd	3rd	4th	Total
COMPONENT	Cost X $1000	**Annual Contributions to Reserves**				
Painting Building One	$12	12	3	3	3	$21
Painting Building Two	$12	6	6	3	3	$18
Painting Building Three	$12	4	4	4	3	$15
Painting Building Four	$12	3	3	3	3	$12
Total Cost	$48	$25	$16	$13	$12	**$66**

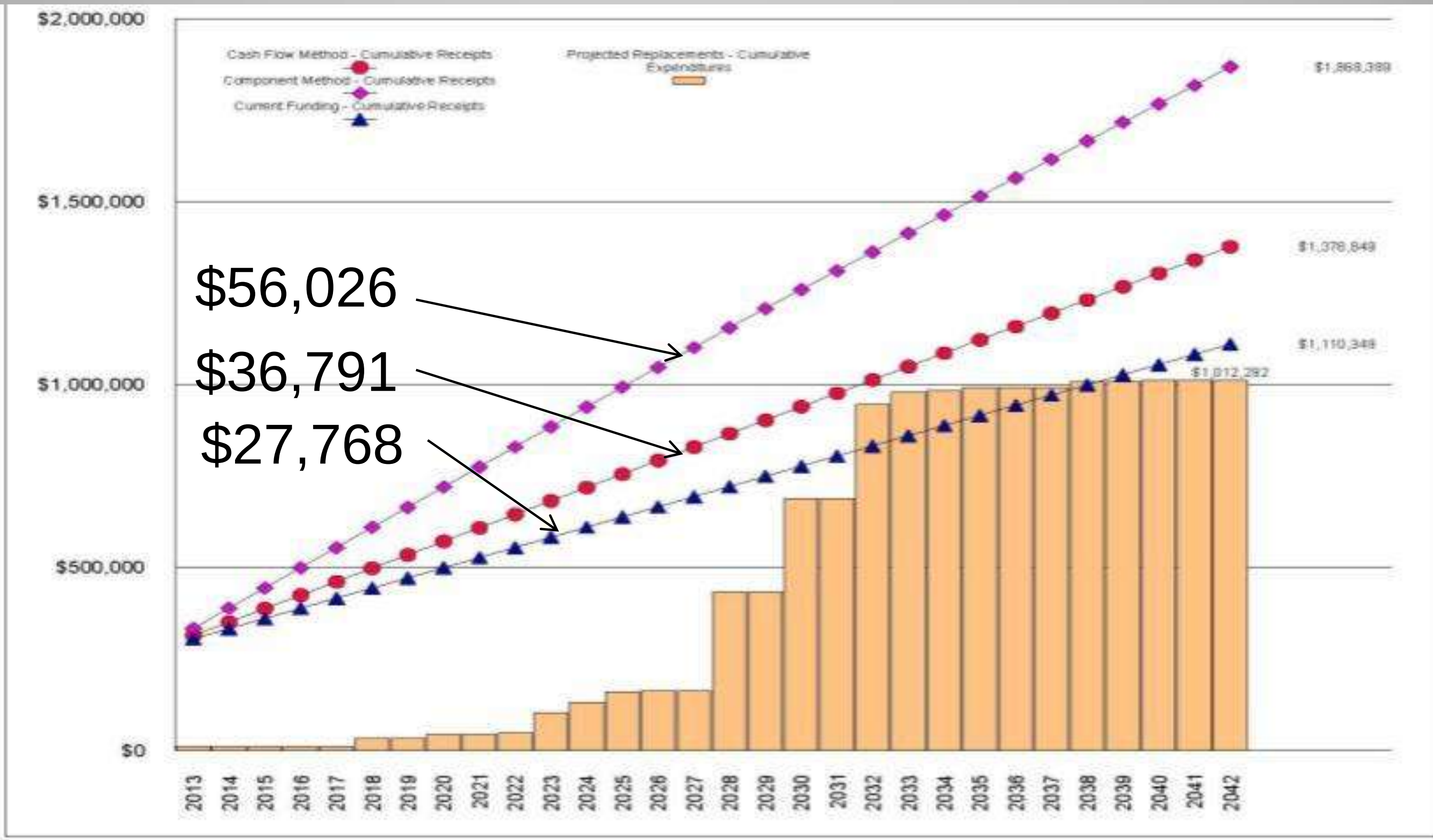
Cash Flow Calculations

	YEAR	1st	2nd	3rd	4th	Total
COMPONENT	Cost X $1000	**Annual Contributions to Reserves**				
Painting Building One	$12	3	3	3	3	12
Painting Building Two	$12	3	3	3	3	12
Painting Building Three	$12	3	3	3	3	12
Painting Building Four	$12	3	3	3	3	12
Total Cost	$48	12	12	12	12	**$48**

Comparison:

- Cash Flow Recommendation: $48K
- Component Recommendation: $66K
- Component Method requires 38% more funding than Cash Flow.
- Cash Flow would be 72% of "Full Funding" if using Component Method.

Glyndon Trace I
Reserve Funding



Questions

Speaker BIO

Peter B. Miller, RS

A Principal in the firm of Miller – Dodson Associates, Peter Miller is considered to be one of the nation's leading experts in the field of Reserve Studies and Strategic Financial Planning for community associations. He holds the professional designation of Reserve Specialist (RS). Mr. Miller is a frequent author and lecturer, and was selected to develop and teach the Community Associations Institute's (CAI) Webinar on Reserves and Reserve Studies.

Peter served as the 2004 President of the CAI's Washington Metropolitan Chapter, and was a member of the Board of the CAI South Carolina Chapter. He has previously served as the 2014 President of the Southeast Virginia Chapter of CAI. He served as Vice-Chair of the CAI National Reserves Standards Committee, and currently serves on the CAI National Business Partners Council. He has been widely recognized for his efforts in the industry, including the CAI National "President's Award" and "Award for Excellence in Chapter Leadership". Peter has also earned the CAI distinction of "Educated Business Partner".

Peter is a graduate of the College of Architecture and Urban Studies at Virginia Tech, and is a member of the Urban Land Institute and The Congress for a New Urbanism.